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International Economic & Energy Weekly [redacted]

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6 May 1983

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International Economic & Energy Weekly [redacted]

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Comments and queries regarding this publication are welcome. They may be directed [redacted] *Directorate of Intelligence* [redacted]

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Synopsis

Perspective—*Soviet Cost of Client States* [redacted] 25X1

Despite slow growth and foreign exchange shortages at home, the Kremlin is shouldering a growing burden of support for its client states. Measured in current dollars, Soviet economic and military assistance to four showcase countries—Angola, Cuba, Ethiopia, and Vietnam—has mushroomed since the mid-1970s, rising from about $1.4 billion in 1975 to a record $7 billion last year. [redacted] 25X1

The Polish Economy: Performance and Prospects [redacted] 25X1

The military regime succeeded in 1982 in slowing the decline in industrial production, increasing the trade surplus with the West, and imposing some austerity on the economy. After a year of martial law, however, Poland's major problems—huge debt obligations, shortages of consumer goods, and worker distrust of the regime—remain, and overall economic performance is expected to remain below the 1978 level for several years. [redacted] 25X1

Sub-Saharan Africa: Long-Term Food Outlook [redacted] 25X1

We believe that few African countries will escape food shortages in the 1980s. Food supply problems are likely to serve as flashpoints for urban unrest. [redacted] 25X1

Oman: Adjusting to Declining Oil Revenues [redacted] 25X1

Oman—dependent on oil for the bulk of government revenues—is likely to run budget and current account deficits in 1983. To shoulder some of the burden of these expenses, Oman is likely to seek additional economic assistance, especially from its richer Gulf neighbors and the United States. [redacted] 25X1

Morocco: Mounting Financial Problems [redacted] 25X1

Hit in recent years by the depressed phosphate market and a severe drought, Morocco resorted to foreign borrowing to cover growing current account deficits. Dealing with the country's serious financial situation may preclude significant economic growth or improvement in the standard of living, and Hassan may have to rely more heavily on his security forces to maintain order. [redacted] 25X1

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6 May 1983

Perspective

Soviet Cost of Client States [redacted]

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Despite slow growth and foreign exchange shortages at home, the Kremlin is shouldering a growing burden of support for its client states. Measured in current dollars, Soviet economic and military assistance to four showcase countries—Angola, Cuba, Ethiopia, and Vietnam—has mushroomed since the mid-1970s, rising from about $1.4 billion in 1975 to a record $7 billion last year. In all, an estimated $35 billion in grants, subsidies, and soft loans were funneled to this group over the past eight years. [redacted] 25X1

The dramatic increase in Soviet assistance reflects the clients' growing economic problems and perceived military needs. Cuba has become the largest burden; nearly one-third of Soviet aid supplied to all LDCs since 1975 has gone to Havana. Except for a lessening of Soviet oil subsidies stemming from lower world oil prices, there is little to indicate Soviet aid to these states will be cut back, at least through this year. In addition, aid to other clients such as Afghanistan and Syria promises to push the burden even higher. [redacted] 25X1

The Cuban economy, in our judgment, is facing its most difficult period since Fidel Castro took power in 1959. Plunging hard currency exports and continued lender wariness point to declining output in 1983, and a greater demand on the Soviet Union for economic assistance. [redacted] 25X1

In 1982 the Soviet Union provided an estimated $4.7 billion of economic assistance and $590 million of military assistance to Havana. With these deliveries, total estimated Soviet aid to Cuba rose to nearly $25 billion since 1975. This aid consists primarily of trade subsidies; last year, for example, Moscow charged Havana as little as $16 per barrel for oil, or half the OPEC benchmark price. In addition, Moscow paid the equivalent of 42 cents per pound for Cuban sugar, five times the 1982 world market price. Moscow also permitted the Castro government to run large soft currency trade deficits with the USSR and funded a number of development projects. [redacted] 25X1

Soviet assistance to Vietnam has more than doubled since the mid-1970s, raising the yearly cost to Moscow to well over $1 billion. Most Soviet economic aid is food, petroleum products, and capital projects. The upgrading of the Vietnamese armed forces following the 1979 border war with China largely accounts for the sharp rise in Soviet arms assistance in recent years. Even though deliveries of Soviet arms dropped back to under $300 million in 1982, they remain well above the pre-1979 average of about $50 million. [redacted] 25X1

Moscow's economic stake in black Africa is minor; less than 10 percent of Soviet assistance has gone to this region. Unlike in Cuba and Vietnam, the Soviets have emphasized military support in Africa while downplaying concessionary economic assistance and handouts. This situation, however, could be changing for Moscow's favored black African clients. The serious economic declines in Angola and Ethiopia may have forced a reassessment last year in Soviet planning. In 1982, both of these countries received relatively large new aid commitments. 25X1

Angola has been unable to reverse the steady erosion of its economy. Once an agricultural exporter, the country now imports 90 percent of its urban food needs; the insurgency has brought its rail system to a near halt; and manufacturing has dropped sharply. The plunge in oil prices—petroleum contributes 80 percent of Angola's export earnings—has placed Angola in an almost impossible situation. The government is virtually bankrupt and heavily mortgaged to Moscow and Havana. 25X1

The USSR has supplied Angola with over $800 million in assistance since 1975, all but $32 million going to the military. Soviet reluctance to pledge anything more than token amounts of economic assistance has strained relations. Moscow last year signed an economic agreement that could ultimately provide $2 billion in credits; however, relatively stringent terms and Angolan wariness about proposed projects could lead to further problems. 25X1

Ethiopia's strategic location on the Red Sea has helped make it the largest recipient of Soviet aid in Sub-Saharan Africa. More than $2 billion in Soviet arms have been received since the Mengistu takeover, and another $1.7 billion in military agreements have yet to be implemented. Soviet economic aid to Ethiopia—about $400 million since 1975—lags far behind the nearly $1.2 billion disbursed by Western donors during the same period. Soviet economic aid has been primarily petroleum subsidies—Moscow has supplied all of Ethiopia's oil since 1980. 25X1

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Briefs

Energy

Algerian-Italian Gas Accord Signed

The signing last week by Algiers and Rome of the final agreement for the purchase of Algerian natural gas will allow gas to begin flowing through the trans-Mediterranean pipeline soon, possibly as early as June. The last obstacle was cleared when the Italian Senate approved a subsidy of $0.53 per million Btu—the difference between the sale price and the market price—to be paid to the state-controlled Italian gas company. Although the agreement calls for sales of up to 20 billion cubic meters over the next three years, Italy reportedly expects to purchase about 2 bcm in 1983, 6 bcm in 1984, 8 bcm in 1985, and 12 bcm annually thereafter. Gas prices will be indexed quarterly to crude oil prices. Production problems in Algeria's major gasfields, however, are likely to prevent it from meeting all of its gas commitments to other countries. Sales of gas through the pipeline offer the greatest profit for Algeria, and Algiers probably will cut deliveries of liquefied natural gas to the United States and other customers in order to meet its commitments to Italy. 25X1

Further Canadian Gas Price Cuts Expected

Ottawa is considering additional price cuts of $1.10 per thousand cubic feet (tcf) on Canadian gas exports. The reduction would apply only to purchases above 50 percent of volumes authorized in current contracts. While the recent reduction in Canada's base export price to $4.40 per tcf was primarily intended to prevent further declines in Canadian gas sales, officials hope that an incentive price of $3.30 on incremental volumes will help recover lost US market share. Most industry sources agree that Canadian gas exports would be more competitive under such a two-tier pricing system. We believe the incremental pricing plan, which has the support of Alberta, the major gas-producing province, will be announced within the next several weeks. 25X1

Sharp Cuts in Japanese Electricity Demand

The Japan Electric Power Survey Committee has cut back its official forecast for electricity generation in the early 1990s by 17 percent to 743 terawatt hours. Reduced projections of economic growth—now expected to average 4 percent annually throughout the decade—and greater weight given to structural changes in the Japanese economy are primarily responsible for the sharp cutbacks in the forecast. Industrial electricity demand, for example, is expected to grow by less than 2.5 percent per year as a result of shifts away from heavy industry to light industrial fabrication and high technology. The forecast, which provides the basis for revising construction plans for the electric power industry, will probably cause a delay of several years in new plant construction programs. Japan's nuclear power program, which was slated for rapid growth, will also be adversely affected. 25X1

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International Trade, Technology, and Finance

Recovery in Steel Production

Non-Communist steel production recovered partially in the first quarter from the depressed levels of late 1982. Based on data for the 29 countries reporting to the International Iron and Steel Institute—representing about 98 percent of non-Communist output—we estimate that crude steel production in the first quarter rose to an annual rate of 380 million tons, up nearly 8 percent from the fourth quarter 1982 level. The increase was accounted for equally by the EC and the United States. While the improving trend is likely to continue, most steel analysts still expect that output for the full year will do little more than recover to the 395 million tons produced in 1982. 25X1

The market, nevertheless, remains weak and the EC Commission is maintaining a tight rein on production in order to sustain the modest price increases it has been able to enforce since the first of the year. Although new orders in the United States and Western Europe are exceeding current production levels, the surge in new orders that occurred early in the year appears to have leveled off and the outlook remains uncertain. In Japan and in most other non-Communist steel-producing countries, no clear recovery is in sight. 25X1

Tentative Agreement on EC Steel Quotas

The EC Council agreed in principle last week to extend the Community's internal system of steel production quotas past the 30 June expiration date. Although West Germany opposes the use of quotas, it acquiesced because it believes quotas are necessary as long as other EC countries continue to subsidize their steel industries. A number of details must be worked out, however, before a final agreement can be reached. The United Kingdom and France argue that they have already taken specific steps to reduce overmanning and excess capacity and hence want preferential treatment when the Commission establishes the quotas. Moreover, the Commission would like to get the program extended until 31 December 1985, when state assistance to the industry is due to be phased out. Questions about extending coverage to additional products, such as heavy plates and beams, and complaints about inadequate price discipline among producers also are yet to be addressed. 25X1

The quota system is an important element of the Commission's strategy for revitalizing the EC steel industry. Without this mechanism the Commission would have an even more difficult time trying to restore the financial health of the industry because supply probably would soon outstrip demands, sending prices spiraling downward. The Commission also wants to keep a tight rein on sales to the United States. If the quota system is eliminated, the resultant overproduction might lead EC steelmakers to try to increase their US sales in violation of the October 1982 US-EC steel accord. EC Commission officials hope to reach final agreement on the extention of the quota system at the next Council meeting scheduled for 25 May in Brussels. [redacted] 25X1

OECD Consensus Rates Extended Through June

The EC, constrained by an inflexible mandate, prevented agreement on new consensus interest rates at the OECD meeting last week on export credits. The OECD agreed to extend the present arrangement—scheduled to expire on 30 April—until 30 June to give the Community time to develop more accommodating proposals. Although other countries were willing to accept a reduction in interest rates on government-backed export credits, the EC's call for a 2-percentage-point drop was unacceptably large. The EC, however, was able to support in principle a new interest rate system—backed by the United States—in which consensus rates would be adjusted automatically to changes in market interest rates once the base consensus rates have been agreed upon. [redacted] 25X1

The EC's mandate largely reflected French demands for a marked reduction in consensus interest rates. France, along with Italy, remains the only Community country having commercial interest rates substantially above the current OECD consensus rates—12.4 percent for countries with per capita incomes in excess of $4,000. While a reduction in the consensus rates increases the French subsidy on officially backed export credits, it also increases the competitiveness of French export financing. With market rates generally falling elsewhere in the OECD, French competitiveness will be further enhanced by the OECD adoption of adjustable rates. Since extending the current fixed consensus rates hurts France's competitive position, we believe France probably will modify its position to allow the EC negotiator more flexibility at the next OECD arrangement meeting to be held 27-28 June. [redacted] 25X1

Western Europe's Space Program on the Line

The European Space Agency (ESA) needs a successful launch to restore customer confidence in the Ariane commercial space program. Ariane has a success rate of only 60 percent, and the first commercial launch in September 1982 was a failure. Although ESA is under pressure to meet its next scheduled launch on 3 June, we do not believe it can do so without risking another failure. [redacted]

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ESA, through the Ariane program, hopes to capture a major share of the market for space launch services estimated by Western experts to be approximately $20-30 billion in the next decade. Questions about launch vehicle reliability, however, have weakened the competitive position of Ariane, and ESA needs a success if it is to remain competitive in the bidding for the launch contract for five of the Intelsat communication satellites. Intelsat probably is waiting for the June Ariane and August shuttle launch by the United States before awarding the contract. ESA has already lost one customer to the United States when the Dutch, a member of ESA, recently decided to cancel their launch contract with Ariane in favor of a launch in May by a US Delta booster. Another Ariane failure probably would result in more customer defections and could place the entire Ariane program in jeopardy. 25X1

EC and Spain Reach Trade Agreement

The EC and Spain have negotiated an agreement that allows Madrid to maintain quotas on imports of selected sensitive items from the EC for up to four years after Spain joins the Community. The EC insisted, however, that Spain's quantitative restrictions on imports of autos from the Ten be removed after accession. Both sides agreed to raise the limits on their textile imports gradually during the first four years of Spanish membership as a means of easing the shock to an industry that is in trouble throughout Western Europe. The agreement may reflect the Commission's desire to mollify the Spanish, who have threatened to withdraw their application for membership because of the lack of progress in the negotiations. Madrid probably will continue to use this ploy in the hope of pressuring the Ten to conclude discussions by next year, opening the way for accession by 1986. 25X1

India Adopts a More Protectionist Stance

Indian officials last month announced measures to protect domestic industry and spur exports. Curbs on trading intermediaries and lower purchases of components and spare parts are expected to help cut foreign purchases by $500 million. At the same time, manufacturers who export a large share of production will be rewarded with additional import licenses and easier access to capital goods that are not produced in India. In addition, private traders may now export a wider range of agricultural items. In our judgment, the new regulations are an attempt to appease domestic producers, deal with last year's $6 billion trade deficit, and cope with expected financial strains over the next several years when IMF support, which now provides about $2 billion a year, will be reduced. A tighter import policy will, however, reduce pressure on domestic manufacturers to become more efficient and will curtail flexibility in using imports to spur industrial growth. 25X1

Spanish Financial Aid For Nicaragua

Spain agreed on 25 April to extend $45 million in credits to Nicaragua over the next three years for the purchase of Spanish goods. Madrid gave Managua $25 million in credits last year, and the total of $70 million makes Spain one of Nicaragua's largest European lenders. A Spanish diplomat in Managua told

US officials that he believes Madrid does not expect repayment. The new credits underscore the Gonzalez government's willingness to use public funds to increase Spain's share of international trade with Latin America. Because they are earmarked for the purchase of Spanish goods, the credits will help stimulate Spain's lagging export industries. Prime Minister Gonzalez probably hopes the credits will have a moderating effect on the Sandinistas as well as loosen Nicaragua's economic ties to Eastern Europe. The Sandinistas, meanwhile, will portray the credits as a sign of international acceptance. 25X1

Comoros Expanding Relations With South Africa

As part of his search for development assistance, Comoran President Abdallah is expanding economic ties with the South African Government. According to the US Embassy, Pretoria has agreed to provide $30 million for the construction of four hotels on the islands. In addition, South African Airlines will start weekly service to the Comoros beginning in July. The Comoros are geographically isolated with a low revenue base, and Comoran officials have told the Embassy that South Africa is the only hope for desperately needed funds. Pretoria, for its part, probably will try at some point to use its assistance as leverage on the Comoran Government to establish diplomatic relations. So far, Malawi is the only black African government to recognize the South African regime. 25X1

National Developments

Developed Countries

Japanese Wage Round Unusually Quiet

Workers in Japan's major industrial sectors this year accepted record-low wage increases averaging 4.4 percent. The compromise was well below the already modest 7 percent unions had demanded and reflected the poor state of the labor market, where only six openings exist for every 10 applicants. The nominal wage settlements suggest a 1-percent increase in real wages. We do not believe this will be enough to spur the lackluster Japanese economy unless consumers trim their saving rate. Without some pickup in consumption, Tokyo will have to give serious consideration to more stimulative monetary and fiscal policies, perhaps this summer when debate on a tax cut is scheduled. 25X1

Spain's 1983 Budget

The Gonzalez government has presented to Parliament a generally conservative budget designed to halt the rapid growth of the public-sector deficit and reduce inflationary pressures. The projected deficit of $8.2 billion for this year represents a $600 million decrease compared with the budgeted deficit for 1982. While the actual deficit may rise to $10 billion because of commitments made by the previous government, the Socialists should still attain their objective of holding the deficit at 6 percent of GDP. Borrowing from the central bank is unlikely to exceed 7 percent of the total financing requirement, compared with about 75 percent in 1981 and 1982. This will curtail the growth of the money supply and should help bring inflation down from its current 14-percent rate to a level closer to the 12-percent target. [redacted] 25X1

Less Developed Countries

Mexico Holding the Line on Wages

President de la Madrid this week refused to grant an early increase in the minimum wage despite intensive lobbying by key labor leaders. Even in the face of widespread distress among the rank and file over falling real wages, 1.5 million workers demonstrated support for the government during the traditional May Day parade. The workers' show of support represents a small but important victory for de la Madrid, who thus far has displayed considerable political skill in managing the crucial labor sector. He will face another difficult test when he decides on the wage increase scheduled for July. [redacted] 25X1

First-Quarter Improvement for Argentina

Although Buenos Aires has not resolved its difficulties, economic performance through March offers a glimmer of hope:

- Inflation, running at 44 percent during the first quarter, is far above IMF guidelines but has decreased steadily since January.
- A trade surplus of $610 million was recorded for January and February, and press reports have touted a $1.25 billion surplus for the quarter.
- Tighter fiscal management has held the public-sector deficit below expectations.
- Despite some slippage on Fund targets, we expect that the IMF team returning to Buenos Aires next week will recommend the disbursement of $330 million later this month. [redacted] 25X1

The first-quarter performance should facilitate completion of the five-year, $1.5 billion commercial bank loan now under discussion. The flow of funds from the banks and the IMF are essential to support the current military regime's efforts to maintain its stabilization program. We expect, however, that pressures for investment projects and spending faciliated by the budget approval in late March could lead to a breakdown of fiscal discipline over the next few months and a subsequent increase in Central Bank credit to the government far in excess of Fund targets. Should the IMF program collapse and cause bank lending to evaporate, a sharply deteriorating financial picture requiring a more austere stabilization plan would await the new civilian government in January. [redacted] 25X1

[redacted] 25X1

[redacted] 25X1

Philippine Balance of Payments Still Weak

Lower international interest rates helped Manila trim the first-quarter current account deficit by $135 million, but the merchandise trade deficit—at $653 million—showed almost no improvement. Despite a near record 8-percent rate of depreciation of the peso and a new import surcharge, imports grew by 3 percent. Manila received the first installment of the recently negotiated $347 million IMF standby loan, but Central Bank reserves still fell by almost $300 million to $1.4 billion, equal to barely two month's imports. At the same time, Manila began experiencing some difficulty rolling over short-term credits extended by foreign commercial banks. [redacted] 25X1

Manila's debt management policies, meanwhile, are stirring domestic criticism. Budget austerity and Central Bank exchange rate policy—both pledged to the IMF to obtain the standby credit—are provoking strong protests from domestic business interests. Late last month Prime Minister Ceasar Virata also drew unusual fire from a ruling party caucus—led by Imelda Marcos—which expressed a lack of confidence in his conduct of economic policy. [redacted] 25X1

Guyana Spurns Latest IMF Offer

Guyana has rejected the IMF's latest terms for a reported $187 million loan, marking the latest development in an 18-month campaign to regain IMF help for the rapidly crumbling economy. Last year real output plunged an estimated 10 percent, consumption 20 percent, and investment 33 percent from already depressed 1981 levels. Mismanagement, corruption, and import constraints will continue to depress production this year in the key rice, bauxite, and sugar sectors, and slack world demand will compound chronic marketing difficulties. The Burnham regime has steadily enlarged state control to over 80 percent of the economy—nearly ruining the private sector—to provide jobs for its followers. IMF and World Bank pressure to revive the business community threatens this arrangement, making it unlikely that an IMF agreement will be reached any time soon. [redacted] 25X1

Aid for Bangladesh

The World Bank–sponsored Aid Club in mid-April committed $1.8 billion—including $500 million in food assistance—to Bangladesh for the fiscal year that begins on 1 July. The new aid commitments represent a 12.5-percent increase over FY 1983 levels. Most members were reluctant to increase their commitments substantially, in part because they felt Bangladesh is unable to absorb large increases in aid quickly and efficiently. Nonetheless, aid commitments at current levels probably will enable Bangladesh to maintain satisfactory economic growth over the next two years. [redacted] 25X1

Ecuadorean Trade Constraints

Despite a $197 million trade surplus in the first quarter as compared with a $25 million surplus in the same period last year, businessmen are complaining increasingly about import controls, rising domestic prices, and a scarcity of foreign exchange. According to Finance Minister Pinto, the devaluation in March of the sucre will boost the overall competitiveness of Ecuadorean exports, which in turn will help ease the government's financing problems through increased revenues. We believe, however, that the economy will continue to falter until Quito obtains IMF and new commercial bank credits, clears up arrearages, or obtains new import financing. [redacted] 25X1

Afghan Development Planning Difficulties

Kabul has shelved its multiyear development plan in favor of an annual approach [redacted] Although the Afghan 25X1 Government has signed agreements—mostly with the Soviet Union and Bloc countries—that would have provided sufficient capital for the multiyear plan, inept handling of foreign funds and lower-than-expected revenues appear to have hampered project implementation. Even in the power sector—one of the few segments of the economy with concrete development plans—the completion of projects is threatened by increasing insurgent attacks on power facilities and lines, which are already resulting in blackouts in Kabul. [redacted] 25X1

Communist

Long-Term Soviet Energy Program

A Soviet economist recently told the US Embassy in Moscow that the USSR will soon announce a 20-year energy program calling for some changes in energy policy involving goals beyond the current five-year plan, which expires in 1985. Some investment is to shift from current oil production to exploration for new deposits, and investment in coal production is to rise. Future hard currency revenues will be obtained by raising gas exports and sustaining oil exports. To do this, the economist said gas would increasingly be substituted for oil in domestic use and domestic allocations of oil might be cut before oil exports, even though this would slow economic growth. [redacted] 25X1

The energy program is one of several new long-term efforts the Soviets are making to focus resources on major problem areas. It appears to be more practical than previous ones. The program will be difficult to carry out, however, because of growing competition for investment resources. In addition, planners are unlikely to make large cuts in domestic oil allocations without a reduction in exports. [redacted] 25X1

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Fast Start for Soviet Spring Grains

The spring grain sowing campaign in the USSR is well ahead of the normal schedule. The Central Statistical Administration reports that as of 25 April, 26.1 million hectares had been sown, double that of a year ago and second only to the record sown in 1975. Additional grainland is still to be planted in the European USSR and east of the Urals. If farmers maintain this pace and complete planting ahead of schedule, chances are good that the spring crop—which usually accounts for two-thirds of total grain production—will reach the crucial flowering stage before the summer's hottest weather. Weather conditions, however, will still play the key role in determining final grain output. Even with a bumper spring grain harvest, damage already sustained by the winter grains will prevent the USSR from reaching its goal of 238 million tons this year. [redacted] 25X1

Beijing Struggling To Regain Control Over Investment

Beijing's inability to slow the growth of investment and heavy industrial production is straining scarce energy supplies and disrupting the production of consumer goods. For first-quarter 1983, heavy industrial output was up 11.7 percent—against a 3-percent plan—while light industry was well below its 5- percent target, registering only 2.5-percent growth. Economic reforms that reduced central control over investment have undermined efforts to impose austere investment plans. Investment last year—40 percent over plan—boosted demand for producer goods, stimulating a much sharper increase in heavy industry than planned, which in turn put greater pressure on scarce energy supplies. [redacted] 25X1

The government late last year took steps to recentralize control over investment spending and legislated heavy financial penalties for above-quota local investment. We do not believe, however, that Beijing can attain the 7-percent reduction in investment planned for 1983 unless the government takes more drastic measures. If first-quarter trends continue, we expect the current squeeze on energy and consumer goods to worsen. More important, we believe Beijing will have difficulty focusing investment funds in critical sectors such as energy and transport, possibly upsetting the country's long-range development program. [redacted] 25X1

The Polish Economy: Performance and Prospects [1]

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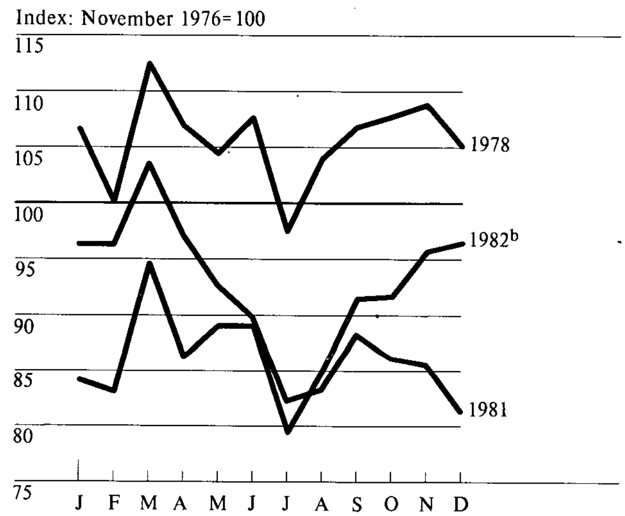
The military regime succeeded in 1982 in slowing the decline in industrial production, increasing the trade surplus with the West, and imposing some austerity on the economy. After a year of martial law, however, Poland's major problems—huge debt obligations, shortages of consumer goods, and worker distrust of the regime—remain, and overall economic performance is expected to stay below the 1978 level for several years. 25X1

Martial Law Policy

A major goal of the martial law regime was to stabilize the economy—industrial output had dropped 15 percent in 1981. The regime appointed military commissars to run more than 200 large factories, reinstituted the traditional longer workweek, established harsh penalties for absenteeism and strikes, and strengthened central controls over industrial inputs and outputs. The Planning Commission continued to set most factory production goals on a quarterly or even monthly basis. 25X1

The regime tried to balance supply and demand, largely by implementing long overdue retail price increases. The government also attempted to increase the supply of goods in state markets by boosting agricultural procurement prices, threatening private farmers with compulsory deliveries, and cracking down on black market sales. Furthermore, the regime sought to cut back investment—which had already fallen by about 40 percent during 1979-81.To cover repayments required by bank rescheduling agreements, Warsaw planned to cut imports from the West drastically and to increase exports.

Poland: Monthly Industrial Production[a]



[a] Seasonally adjusted.
[b] Estimated.

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Results

The regime had mixed success in attaining its goals. Overall economic activity declined by about 4 percent in 1982, an improvement compared with the 5.4-percent decline in 1981:

- Industrial production was only 2 percent below 1981.
- The extractive industries boosted output by 11 percent largely because coal production rose 16 percent. 25X1

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Main Indicators of the Polish Economy

	1978	1979	1980	1981	1982
Gross national product [a] (index: 1977=100)	103.6	101.8	98.5	93.2	89.5
Industrial production [b] (index: 1977=100)	101.6	100.7	99.4	84.7	83.0
Coal *(million tons)*	192.6	201.1	193.1	163.0	189.3
Copper *(thousand tons)*	332	336	357	327	348
Raw steel *(million tons)*	19.25	19.22	19.49	15.72	14.47
Rolled steel products *(million tons)*	13.57	13.57	13.55	11.06	10.48
Agricultural Production [b]					
Grain *(million tons)*	21.5	17.3	18.3	19.7	21.2
Potatoes *(million tons)*	46.6	49.6	26.4	42.6	32.0
Sugar beets *(million tons)*	15.7	14.2	10.1	15.9	15.1
Cattle *(million head)*	13.1	13.0	12.6	11.8	11.9
Hogs *(million head)*	21.7	21.2	21.3	18.5	19.5
Investment [b] (index: 1977=100)	102.1	94.0	82.4	62.8	51.2
Real wages [b] (index: 1977=100)	97.3	99.2	103.2	104.2	80.6
Consumer prices [b] (index: 1977=100)	108.7	116.0	126.6	157.5	315.0
Trade with the West [c]					
Exports *(million US $)*	5,481	6,350	7,506	5,448	5,639
Imports *(million US $)*	7,368	8,038	8,488	5,422	4,174
Financing requirements [a] *(billion US $)*	5.8	6.7	7.8	10.0	11.2
Gross debt [a] *(million US $)*	17,844	22,669	24,840	25,500	24,300

[a] Western estimate.
[b] Polish Statistical Office, Polish Statistical Yearbook, 1982.
[c] Customs data.

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- Manufacturing output dropped 3 percent because of the lack of Western inputs and shortages of skilled labor as the government implemented new liberal early retirement policies.
- Investment fell 18 percent from the previous year.
- Agricultural output dropped 4.5 percent, with crop production down 3.3 percent and the output of livestock products down 5.8 percent.

Despite an above-average grain harvest, the government failed to buy enough grain from private farmers to meet state retail needs because many farmers used the grain to feed their livestock. The output of potatoes, meat, eggs, and milk declined, adding to food shortages in state markets. 25X1

Warsaw ran a trade surplus of nearly $1.5 billion with the West in 1982.[2] According to Polish customs data, imports from the West declined 23 percent while exports to the West increased 4 percent. Although imports of capital investment goods fell 48 percent, imports of raw materials and

[2] Payments data show a surplus of $350 million. On a customs basis, the surplus was nearly $1.5 billion. We have not been able to explain the large discrepancy. 25X1

spare parts for industry declined only 11 percent, an indication that the regime seems to have concentrated on purchases of goods needed to help sustain industrial production. Exports of fuel and energy products increased 35 percent, while exports of machinery and spare parts dropped 29 percent, chemicals 13 percent, and consumer goods 25 percent.

The doubling of prices in February 1982 helped for a short time to better balance overall consumer supply and demand. Demand pressures grew later in the year, however, because of increases in wages and social benefits, including wage hikes granted late in the year by some enterprises exercising their powers under the economic reform. As a result, purchasing power at the end of 1982, according to Polish economists, exceeded the supply of goods and services by 15 percent—the same as before the price increases. Moreover, the impact of the austerity measures was uneven. The average Polish worker, whose real wages declined 23 percent, experienced acute economic hardship and, because of high prices, could not even buy all the goods available to him on his ration cards. On the other hand, some high income groups, especially professionals, private businessmen, and coal miners, continued to wield considerable purchasing power.

The government failed to implement some planned economic reforms—including a reform of producer prices and factory self-financing measures—because of fear that some firms would earn exorbitant profits while others would be forced into bankruptcy. Instead, the government generously subsidized factories that were technically bankrupt, allocating 46 percent of the national budget for this purpose. Moreover, to guard against profiteering, the government levied a number of new taxes on enterprises—including a progressive income tax ranging as high as 90 percent—that seriously weakened the profit incentive. The regime also refused to grant significant powers to its newly formed trade unions and workers' councils, largely out of fear that Solidarity would use them to regain power.

Poland: Non-Communist Trade

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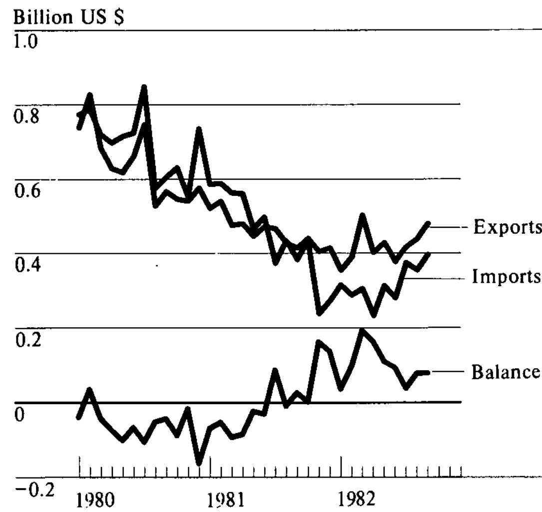

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Financial Crisis Continues

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Warsaw had to repay Western creditors $11.2 billion in 1982, including $9.8 billion in debt service due under original loan contracts and $1.4 billion in unrescheduled obligations carried over from 1981 and payments due under 1981 debt relief agreements concluded with private and government creditors. Warsaw was able to pay only about $2.2 billion and to reschedule less than $3 billion, leaving arrears of $6-7 billion. An agreement with private banks rescheduled 95 percent of 1982 principal obligations—worth $2.3 billion—and required Poland to pay $1.1 billion interest in late 1982 and 1983. The banks agreed to provide Warsaw with one-half the value of interest payments in short-term credits.

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Poland ended the year with $4.4 billion in arrears to Western government creditors and with limited prospects for a favorable government rescheduling in 1983.

Less Aid From the East. Poland's reduced levels of aid from the USSR and the other CEMA countries in 1982 failed to compensate for reduced Western inputs. In 1982, the Soviets had planned to allow a soft currency trade deficit equivalent to $1.6 billion, but the Poles ran only a $1.2 billion deficit—$800 million less than in 1981. Moscow also supplied about $44 million in hard currency to buy Western parts for exports destined for the USSR, sold raw materials to Poland at favorable prices, granted a 500,000-ton grain loan, and provided some above-plan deliveries of materials to boost production in idle factories.

Poland ran almost balanced trade with its non-Soviet CEMA partners in 1982. According to the Polish press, however, Bulgaria and Hungary did provide Poland with small amounts of hard currency to buy Western inputs for products exported to their countries. All East European CEMA countries, except East Germany, also promised to help Poland complete major investment projects, but there were few signs of progress in 1982.

Prospects for 1983

Poland will have difficulty meeting the regime's modest goals for 1983—2- to 2.5-percent growth in national income, 3.7-percent growth in industrial production, and 1.5-percent growth in agricultural output. Even achieving these targets would recover only one-fifth of the decline in national income since 1978. Investment is scheduled to remain at the low 1982 level.

Warsaw's success in achieving its national income and industrial production goals this year will depend largely on the country's ability to secure vital Western imports. If Warsaw imports the same level of goods as in 1982 and continues to give priority to critical imports for the industrial sector, the country could meet its industrial growth target. On the other hand, if Warsaw's trade credits are cut or if it chooses to pay more of its debt service obligations by running a larger trade surplus than in 1982, the necessary import cuts would prevent it from meeting growth targets.

Fulfillment of the industrial plan will be helped by the government's extension of the workweek to 46 hours in key enterprises, continued militarization of some enterprises, and encouragement of overtime in factories with sufficient raw materials. The planned growth in agriculture, however, will be difficult to attain because of a likely decline in livestock numbers and unfavorable winter grain crop prospects.

One of the regime's major goals in 1983—which it probably will not reach—is to increase supplies of consumer goods by 8 to 9 percent, largely through more efficient management and an extensive raw material and energy conservation program. At the same time, the government intends to take some measures to reduce demand:

- Retail prices are projected to rise 15 percent.
- Pay increases will be held to 16 percent.
- Restrictions will continue on consumer credits.
- Social spending may be cut.

In addition, property taxes—which especially affect private farmers—probably will be raised, and income taxes will be applied on the wealthy for the first time.

The Soviet Union has promised to permit Warsaw to run a trade deficit equivalent to $1.7 billion this year and to adjust the composition of trade to Poland's benefit. Moscow intends to import more Polish machinery and fewer consumer goods and foodstuffs, while increasing by 15 percent its exports of industrial materials to Polish industry.

Warsaw's huge carryover of arrears will leave $13.9 billion in debt service due this year, including $4.4 billion in arrears from 1982, $5 billion in

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principal payments on medium- and long-term loans under original loan contracts, and about $4 billion in interest, including charges on rescheduling agreements. Even if the Poles run a current account surplus of $1 billion in 1983, roughly the same as in 1982, Warsaw would still have a $12.9 billion financing gap. Since the outlook remains poor for new credits, the 1983 financing requirement will have to be covered by debt relief, either under formal agreements or by creditors' continued tolerance of arrears.

Longer Term Prospects

Warsaw's massive debt obligations will be a key constraint on economic growth. The regime will be strapped for hard currency throughout the 1980s and will have to make tough choices between servicing its debts or importing the inputs necessary for economic growth. Warsaw probably will seek total debt relief and new credits and, if unsuccessful, will continue the de facto moratorium on debt service owed to governments. In addition, without more generous rescheduling terms from Western banks and an upturn in lending, Warsaw may choose to extend the moratorium to other types of debt. With the financial bind continuing, Warsaw will have little hope for boosting imports, with consequent negative repercussions on growth prospects.

We believe there is little chance for Poland to significantly increase hard currency exports. Most of Poland's manufactured goods already sell for 20 to 50 percent less than similar Western goods, and the Poles are not having much success improving product marketability in Western markets. In addition, output of raw materials—which provided almost 30 percent of hard currency earnings in 1981—will increase slowly as a result of the lack of investment in the raw material sector during the last five years.

The Poles' current plans to hold down investment will retard economic recovery in the longer term. The transportation network, especially the rail system, is in serious need of repair. The chairman of the Sejm Coal Commission has said that hard coal production will not increase above the 1982 level through 1990 unless new mines are opened. Domestic oil and gas supplies—which provide a small but important part of Polish needs—are dwindling. 25X1

The Poles also have not allocated sufficient funds for a conservation program to reduce the use of materials per unit of output. Such a program is essential to the success of the 1983-85 Plan: one-half of the 40-percent growth in industrial production through 1990 is projected to come from increased efficiency. The regime will find it difficult to increase worker productivity because of deep-seated worker distrust and apathy and because of the austerity that is expected to last at least until the end of the decade. 25X1 25X1

Two other factors—economic reform and Soviet assistance—could provide some help, but, on the basis of past experience, we believe there is good reason to doubt that the benefits will be as great as the Poles may hope. We doubt that major portions of the reforms will be implemented soon and believe that bureaucratic resistance could easily undermine many reform measures already instituted. The Soviets probably will continue to provide Poland with raw materials on favorable terms but will try to trim back other forms of aid because of their own economic problems. 25X1 25X1

In our view, Poland may be able to achieve small increases in national income and industrial output over the next three years, but economic output seems likely to remain below the 1978 level at least until 1986. Continually trying to meet the conflicting goals of stimulating economic recovery, paying creditors, and improving living standards, the regime probably will make only limited progress in each area. 25X1

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Sub-Saharan Africa: Long-Term Food Outlook [1]

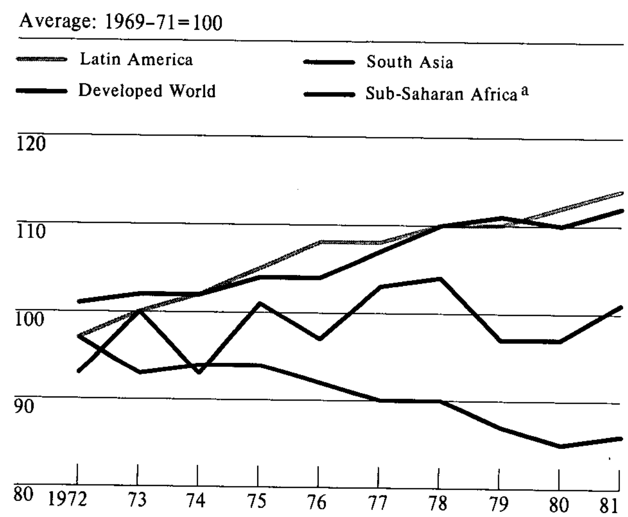
25X1

Food has become one of Sub-Saharan Africa's most pressing problems.[2] Drought-related crop failures this year throughout southern Africa and in Ethiopia highlight once again the precarious balance between supply and demand in most of the region. Shortages and price increases have helped trigger civil disorder in the region in recent years, and we believe that politically volatile urban Africans will be even less inclined in the future to tolerate shortages. Consequently, food problems will increasingly serve as flashpoints for civil unrest and as rallying points for challenges to governmental authority. 25X1

Declining Self-Sufficiency

The growth rate of food production in Sub-Saharan Africa, already the lowest of any region in the developing world, is declining. The average annual rate of increase in production in the 1970s was 1.5 percent—down from about 2.0 percent during the preceding decade and less than half the rate for all developing countries, according to the World Bank. Per capita production has dropped even more as a result of an accelerating population growth rate. By 1981, overall per capita food production in the region had fallen 14 percent below the 1969-71 level, according to the US Department of Agriculture; even the most productive countries generally managed only to record low growth during this period. The exception is Ivory Coast; per capita food production there rose 25 percent. 25X1

Indexes of Per Capita Food Production for Selected Regions, 1972-81



a Includes Sudan.

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The slow growth of food production stems from a number of factors common to most African states:

- Postindependence African leaders tended to view the agricultural sector as a source of revenue to finance industrial development, thus devoting few resources to the production of food for domestic consumption. 25X1

- The investment that has taken place has tended to be funneled into large-scale, government-run operations that have been plagued by poor administration, overstaffing, and inability to properly maintain equipment and infrastructure. 25X1 25X1

[2] The term "Sub-Saharan Africa" refers to all of the African continent with the exception of South Africa and the North African states with Arab-controlled governments (Algeria, Egypt, Libya, Mauritania, Morocco, Sudan, and Tunisia).

- Official producer prices set low to subsidize urban consumers have not provided adequate incentives for increased food production.

- Yields of most major African staples are among the lowest in the world, largely due to traditional cultivation methods.

- Drought, floods, crop diseases, and insect infestations also reduce crop yields.

- Political turmoil associated with guerrilla activity and refugee movements frequently disrupts normal planting and harvesting schedules and marketing patterns. [redacted]

Rising Demand

The slowdown in the growth of food output has coincided with a rapid escalation in demand, due primarily to the high rate of population growth. Sub-Saharan Africa's population—estimated by the UN to have been 330 million in 1980—is increasing at the rate of about 3 percent per year, the highest for any region in the world. Urban food demand is growing most rapidly; the annual urban population growth rate of 5.9 percent is far outstripping the 1.5-percent annual growth rate of food production. Growing urbanization of the African population has created a food demand structure that is difficult to supply from local resources. Taste preferences of Africans change when they move to cities—urban Africans tend to turn away from local grains, roots, and tubers in favor of imported foods such as wheat and higher quality rice. [redacted]

Growing Dependence on Food Imports

During the 1960s, African governments found that the food needs of growing urban populations could be satisfied more easily with cheap imported grains than with locally produced foods. Subsidies on imported foods have reinforced consumer preference for imported rice and wheat, dampening demand for local staples. As a result, imported foodstuffs have assumed increasing importance in urban markets as a means of meeting both rising demand and changing tastes. Grain imports exceeded 8.6 million tons in 1981, compared with 1.2 million tons in the early 1960s. [redacted] 25X1

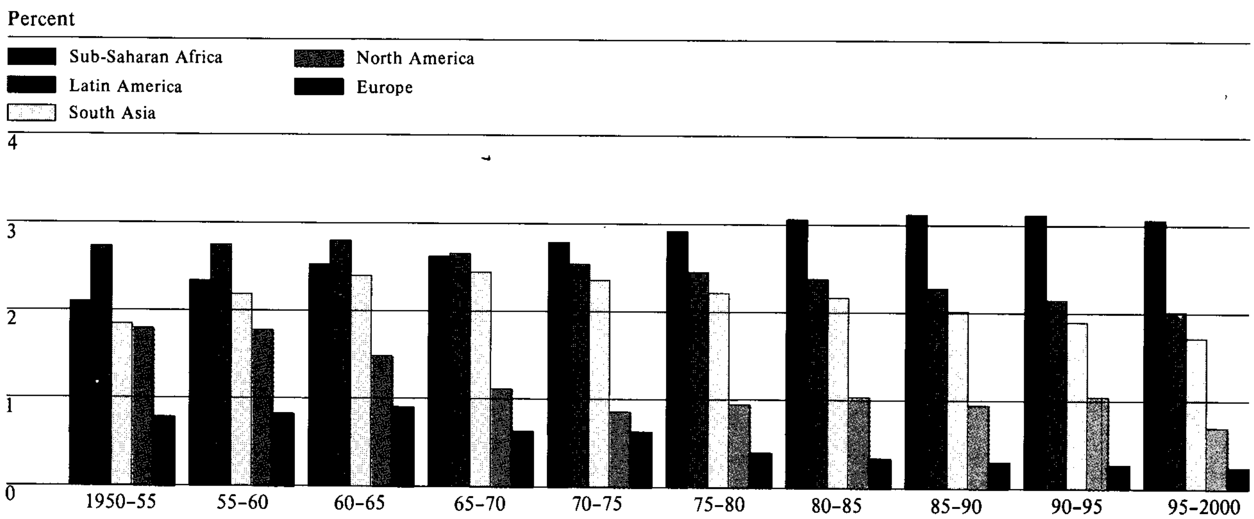
An FAO study of African food purchases indicates that most imported grain comes from the United States, Western Europe, Canada, and Australia. With the exception of South African maize exports, legal grain trade among African countries is low. Poor transport links, inadequate storage facilities, high tariffs, and the lack of foreign exchange are the primary obstacles. Nevertheless, price differentials between countries spur considerable illegal grain trading. According to the USDA, for example, subsistence crops in Benin and Cameroon are illegally exported to northern Nigeria. [redacted] 25X1 25X1

Paying for imported food has become a significant burden for the majority of African governments. We estimate that Africa's food imports in 1982 cost about $5 billion. USDA reporting in 1982 indicates that food imports consumed more than 25 percent of export earnings in The Gambia, Senegal, Sierra Leone, Somalia, and Togo. As a result of their increasingly precarious financial positions, most African nations rely on Western donors for food aid in the form of concessional sales or grants. We estimate that 40 African nations received a total of about $500 million of food aid from Western donors in 1981. The United States was the largest single supplier of this assistance, with over 60 percent of the total. [redacted] 25X1 25X1

Government Pricing and Marketing Policies

Since 1980, several countries have reversed course by raising producer prices of staple foods above world market levels in order to encourage production. Maize farmers in Kenya, Zambia, Tanzania, and Zimbabwe responded to recent price hikes with substantial increases in production. Over the longer term, however, the attractiveness of higher producer prices may be eroded by other factors such as

Annual Rates of Population Increase for Major Regions of the World, 1950-2000



[redacted] 25X1

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high production costs and lack of necessary materials. In Zambia, where a 15-percent price increase for maize in 1981 brought about a boost in the acreage planted, USDA analysts warn that price incentives could be dampened by shortages of agricultural materials and equipment, transportation problems, and scarce credit. [redacted]

Some governments are trying to stimulate production by liberalizing marketing practices and giving freer rein to private traders:

- Senegal has abolished its official cereals marketing board and eliminated government procurement of cereals.
- Mali has relinquished its monopoly control on sorghum and millet, in partial response to IMF insistence on grain marketing liberalization as a precondition for a standby accord.
- In 1981, Somalia abolished several parastatals and turned their functions over to the private sector.
- Zambia has reduced the role of its agricultural marketing board, allowing cooperatives in some provinces to become the official maize buyers. 25X1
- Upper Volta's grain marketing parastatal has attempted to encourage production by setting floor prices for grain and sorghum higher than those offered by private traders and by entering the market only when it can offer a better price than private traders. [redacted] 25X1

Constraints on Future Food Production

We believe that the financial, physical, and human resource problems that have constrained African

Sub-Saharan Africa: Food Supply Indicators

	Per Capita Food Production, Annual Average 1979-81 (Index: 1969-71 = 100)	Self-Sufficiency in Grain [a] Annual Average 1979-81 *(percent)*	Average Daily Per Capita Caloric Intake as a Share of Requirements,[b] 1976-78 *(percent)*	Annual Average 1976-78 *(thousand tons)*			1981 *(thousand tons)*		
				Grain Imports	Food Aid, Grain	PL 480 Aid, Grain	Grain Imports	Food Aid, Grain [c]	PL 480 Aid, Grain [d]
Total	NA	NA	NA	**3,549.9**	**876.4**	**248.5**	**8,629.3**	**1,459.2**	**899.7**
Angola	72	58	69	153.7	8.0	1.2	244.3	21.8	4.1
Benin	97	86	94	41.3	7.5	2.1	93.2	7.9	2.9
Botswana	NA	37	73	39.5 [e]	5.9	5.5	57.8	0	0
Burundi	90	94	106	30.5	7.8	3.1	18.5	7.2	7.2
Cameroon	98	87	101	104.6	4.8	2.5	106.0	10.1	7.7
Cape Verde	NA	7	77	NA	34.8	11.9	46.5	36.0	20.9
Central African Republic	NA	89	98	11.5	1.4	0.8	13.4	0.9	0.9
Chad	NA	NA	76	14.2 [f]	32.3	13.7	14.2	NEGL	NEGL
Comoros	NA	NA	NA	NA	NA	NA	32.0	0.9	0.9
Congo	NA	21	95	60.8	3.2	2.4	55.9	0.8	0.8
Djibouti	NA	NA	NA	NA	NA	NA	32.4	6.9	5.0
Equatorial Guinea	NA	NA	NA	NA	NA	NA	5.3	0.4	0
Ethiopia	68	94	69	70.3 [f]	102.3	18.5	207.3	114.3	10.0
Gabon	NA	24	NA	27.6	NA	0.1	34.7	0	0
The Gambia	NA	62	101	40.9	10.5	3.2	48.4	5.0	1.2
Ghana	69	76	84	211.9	63.8	15.0	256.0	52.7	42.5
Guinea	95	77	83	54.8	39.3	7.8	134.2	29.9	22.2
Guinea-Bissau	NA	62	100	NA	27.7	6.1	26.5	12.6	10.1
Ivory Coast	125	66	116	243.3	NA	0.4	619.3	NEGL	NEGL
Kenya	99	91	96	43.1	8.8	3.1	533.9	173.7	134.4
Lesotho	NA	71	95	63.3	19.1	13.0	95.1	28.0	23.2
Liberia	104	70	97	61.3	1.2	0.6	110.9	31.9	31.3
Madagascar	88	91	107	174.6	9.3	1.3	267.8	28.9	17.9
Malawi	99	97	93	40.2	2.6	0.6	113.3	14.5	14.4
Mali	80	94	76	30.8	26.5	7.9	101.6	28.6	0
Mauritius	NA	1	NA	NA	NA	NA	175.3	13.1	13.1
Mozambique	73	56	73	192.0	101.8	8.2	367.9	53.9	20.0
Namibia	NA	NA	95	NA	NA	NA	NA	0	0
Niger	104	83	85	23.4	43.2	12.9	89.1	7.6	2.6
Nigeria	85	82	86	925.0	0.4	0.4	2,440.5	0	0
Rwanda	108	70	82	6.5	12.8	4.5	15.9	8.3	5.4
Sao Tome and Principe	NA	11	NA	NA	NA	NA	7.9	1.1	0.4
Senegal	75	62	108	154.4	89.1	28.0	458.3	92.4	45.2

Sub-Saharan Africa: Food Supply Indicators (continued)

	Per Capita Food Production, Annual Average 1979-81 (Index: 1969-71 = 100)	Self-Sufficiency in Grain [a] Annual Average 1979-81 *(percent)*	Average Daily Per Capita Caloric Intake as a Share of Requirements,[b] 1976-78 *(percent)*	Annual Average 1976-78 *(thousand tons)*			1981 *(thousand tons)*		
				Grain Imports	Food Aid, Grain	PL 480 Aid, Grain	Grain Imports	Food Aid, Grain [c]	PL 480 Aid, Grain [d]
Seychelles	NA	NA	NA	NA	NA	NA	6.9	1.3	0.5
Sierra Leone	91	86	97	37.7	8.5	4.1 [h]	57.5	10.9	6.9
Somalia	NA	45	77	73.9	1.2 [e]	12.2	432.0	203.3	142.0
Swaziland	NA	83	94	13.0 [f]	NA	0.5	20.0	0.3	0.3
Tanzania	98	88	81	108.1	108.1	25.1	265.0	195.5	104.4
Togo	82	85	95	NA	12.0	8.1	62.0	2.0	2.0
Uganda	78	97	80	15.3	NA	0.1	36.9	37.6	29.7
Upper Volta	86	94	71	39.0	35.8	20.2	71.4	34.3	25.3
Zaire	86	66	83	381.6	29.3	1.1	538.3	64.2	56.2
Zambia	94	73	95	61.8	17.4	2.3	295.0	101.4	73.4
Zimbabwe	82	105	109	NA	NA	NA	20.9	18.9	14.7

[a] Percent of grain self-sufficiency = (grain production)/(grain production + net grain imports) x 100.
[b] Per capita food intake was calculated as the quantity of food available for human use at the retail level after provision was made for change in food stocks and the supplies of food traded, fed to livestock, used as a seed or for individual purposes, or lost in collection, processing, or marketing. Recommended caloric intakes are those established by FAO and WHO in 1973.
[c] Includes aid only from signatories of the Food Aid Convention of 1980. FAC members include Argentine, Australia, Austria, Canada, the European Economic Community, Finland, Japan, Norway, Spain, Sweden, Switzerland, and the United States.
[d] October 1980–September 1981.
[e] 1976-77 average.
[f] As reported. Actual quantities are probably higher.
[g] Figure does not include $1.3 million of commodities for which the tonnage is unknown.

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agriculture during the past two decades cannot be redressed significantly during the rest of the 1980s:

- Modern agricultural materials and equipment, such as imported seeds, fertilizers, chemicals, and machinery, are too costly for most farmers, and budgetary problems will constrain government subsidization of such materials.

- The continuing migration of young males to urban areas will raise rural wage rates, pushing up production costs.

- African governments will have difficulty funding the research necessary to adapt high-yield technology to local conditions and will have trouble supporting extension services to disseminate this technology to farmers.

- An inadequate system of transport and storage facilities will hinder the marketing and distribution of both foodstuffs and agricultural materials.

- The potential for increasing food production by bringing new land into cultivation is large, but preparing these lands will require high levels of investment.

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We believe that conditions in Africa over the next decade do not favor a "Green Revolution" in food production such as occurred in Asia in the 1960s. The Green Revolution was made possible by a combination of factors: the existence of an extensive irrigation network, the development of high-yield varieties of rice and wheat suitable to areas with access to controlled water supply and fertilizer, and relatively good transportation links between producers and markets. None of these conditions currently exist in Africa. In addition, development of high-yield plant varieties suited to African rainfed agriculture must take into account widely varying soil and climatic conditions. Rice breeders have developed some suitable high-yield varieties, but, according to the USDA, their use is limited by disease and other environmental problems. Neither does the USDA foresee a technological breakthrough for millet or sorghum. Use of existing improved plant varieties is hampered by the logistic difficulties in distributing hybrid seeds, adulteration of seeds by farmers, and storage problems.

Government Options Limited

We believe that African governments face difficult policy choices in the years ahead as they attempt to ensure adequate food supplies, reduce import dependence, and lower consumer subsidies. Although African leaders are likely to try to solve their food problems by allocating an increasing share of investment to food crop production, we believe that severe financial constraints associated with slowed economic growth and rising trade deficits will sharply limit spending. Moreover, decisions on how to allocate scarce resources will require tough choices between export-oriented cash crops—important sources of foreign exchange—and import substitution programs in the food sector.

Perhaps most difficult, in our judgment, are the politically risky pricing and trade policy reforms necessary to improve incentives to farmers, because such reforms will come at the expense of urban consumers. We believe that African leaders prefer not to antagonize urban residents by lowering food subsidies, despite recommendations by economic advisers and foreign creditors. Governments that have little choice but to lower consumer subsidies may still try to protect the interests of key groups, such as the military. Mali, for example, has loosened its control on grain marketing and has raised consumer prices, as stipulated in an agreement with the IMF, but noted in late 1981 that it would still try to provide cheap grain for certain categories of public employees. 25X1

Impact on Import Requirements

Barring major changes in policies, we believe that food imports will have to increase substantially to satisfy politically important urban consumers. The USDA, FAO, and the International Food Policy Research Institute have projected that annual demand for food imports in Africa will reach 10-12 million tons in 1990 if production and consumption 25X1 trends of the 1970s continue. We believe that import requirements could be even higher. According to FAO, grain imports totaled 8.6 million tons in 1981, compared with 3.5 million tons annually, on average, during 1976-78. 25X1

The ability of Africans to pay for food imports will be limited by increasing financial problems. Relying on international financial institutions for funding is, in our opinion, not a realistic alternative. The IMF decided in May 1981 to extend its compensatory financing facility to provide assistance to members having balance-of-payments difficulties as a result of increasing costs of cereal imports. Malawi and Kenya have been helped by the program, and we anticipate that other African states will also turn to the IMF for assistance. The facility's resources are too limited, however, to 25X1 cover more than a fraction of the region's food needs. 25X1

Implications for the United States

We believe that few African countries will escape food shortages in the 1980s. Urban Africans, increasingly beset by rising prices and declining living standards, will be especially hard hit. Food supply problems are likely to serve as flashpoints for urban unrest. Even if violence does not erupt, a serious food shortage could become a rallying point for political opposition. [redacted] 25X1

We believe that African leaders will look increasingly to external sources—particularly the United States—for food and for financial and technical assistance in building domestic food production capabilities. Governments may interpret the nature of Washington's response as a gauge of our commitment to Africa's needs. US relations with strategically important countries such as Nigeria, Kenya, and Somalia could be weakened if Washington is not viewed by their leaders as sensitive to their food needs. Kenya's President Moi and Somalia's President Siad, for example, place particular emphasis on US food aid, and their anxieties about the usefulness of their decision to open their military facilities to US forces may increase if they believe US food aid, as well as other assistance, is inadequate. Nigeria, whose membership in OPEC precludes its qualifying for PL 480 aid, will be in the market for other kinds of financial assistance to help cover its food gap. Embassy reporting indicates that the request might include a barter arrangement involving US food and Nigerian oil or concessional financing of US agricultural investments. [redacted] 25X1

[redacted] 25X1

Oman: Adjusting to Declining Oil Revenues

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Oman—dependent on oil for the bulk of government revenues—is likely to run budget and current account deficits in 1983. Revenue shortfalls could stimulate domestic criticism of high defense expenditures and the role of foreigners—especially the British—in Oman. Omani planners have yet to cut government spending much. Oman will probably adhere to current welfare, development, and defense plans unless there is a further decline in oil prices. To shoulder some of the burden of these expenses, Oman is likely to seek additional economic assistance, especially from its richer Gulf neighbors and the United States. Even if aid does not materialize, we believe that Oman is still in a good position to weather the downturn in the world oil market. Oman could draw down its foreign assets—estimated at about $4 billion, or borrow on the international market.

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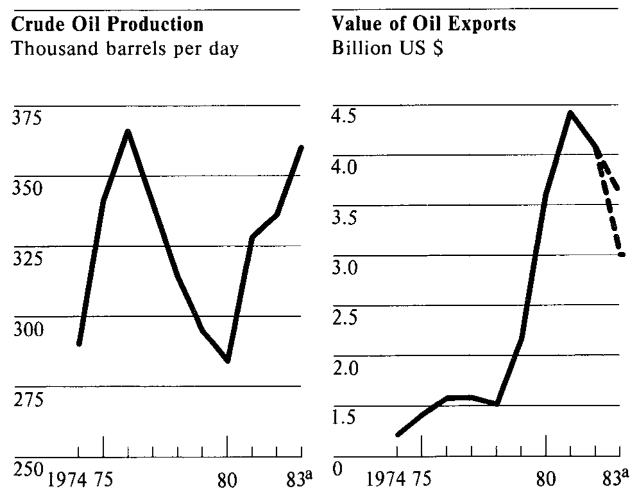
Recent Trends

Oil provides about 85 percent of total government revenues and over 60 percent of Oman's GDP. Proved recoverable reserves are 2.7 billion barrels—enough to last about 20 years at current production rates of between 350,000 and 370,000 b/d. Oman exports nearly all of its crude production, about one-half to Japan. According to a well-informed source, Oman plans to increase its crude production to help offset the downturn in oil prices, but increased oil production much over present levels is constrained by pipeline capacity—estimated to be about 390,000 barrels per day—and bottlenecks in the system. Thus, if oil prices continue to fall, so too will Oman's revenues. We estimate that for each $1 decline in the price of oil, Oman stands to lose close to $130 million in earnings from oil exports.

Oman: Oil Production and Exports



[a] Projected.

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Despite a projected 15- to 30-percent decline in oil revenues in 1983, we project that government spending will rise by almost 8 percent to about $4.4 billion—an indication of the government's unwillingness to cut spending for military programs, economic development, and social welfare. Sultan Qaboos continues to give defense the highest priority—40 percent of budgeted expenditures—because of potential threats from South Yemen and Iran. Qaboos also has increased spending on social programs and economic development an average of 25

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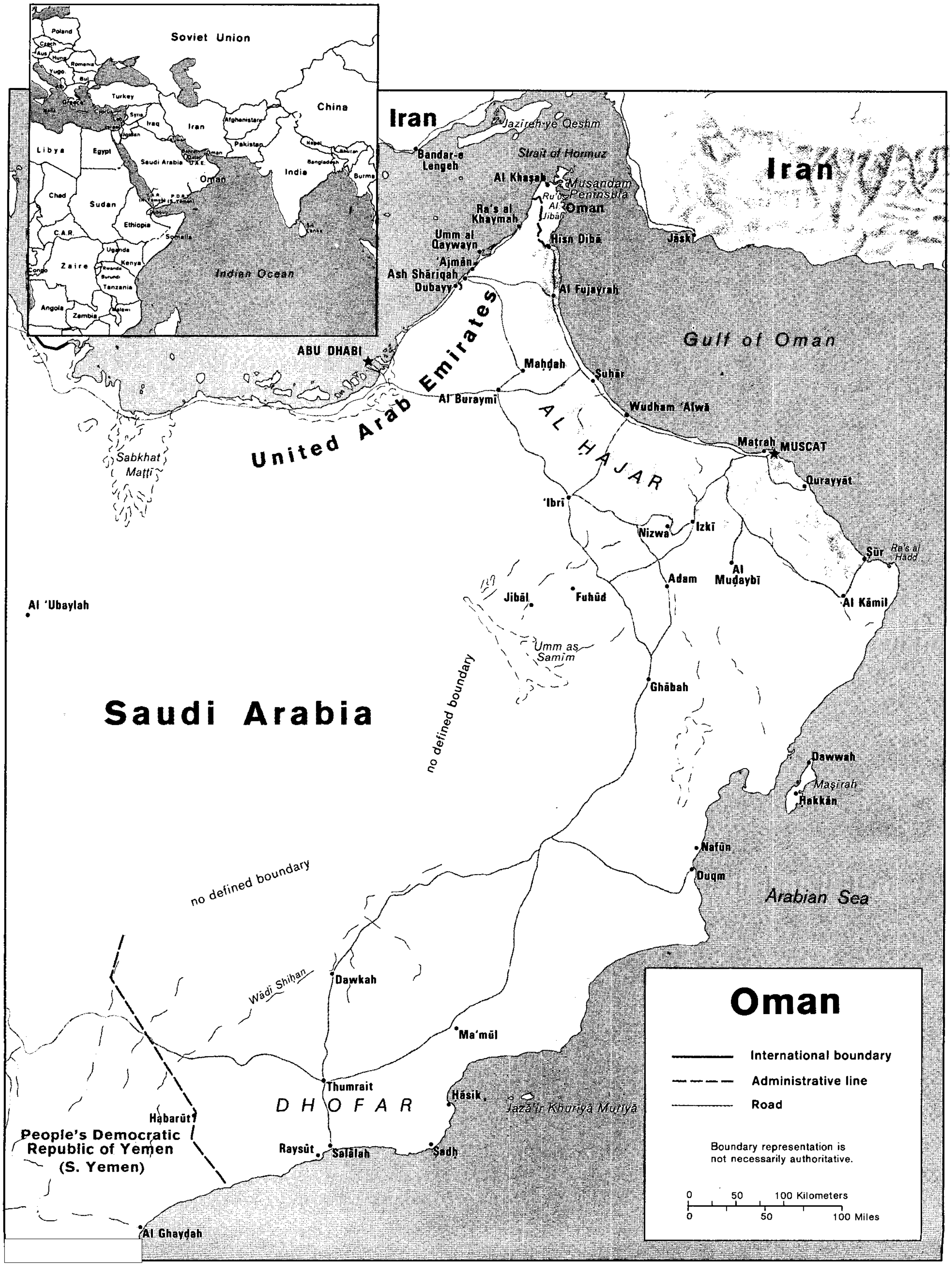

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Oman: Government Finances *Million US $*

	1974	1975	1976	1977	1978	1979	1980	1981	1982 [a]	1983 [b]	1983 [c]
Revenues	902	1,330	1,463	1,774	1,473	2,184	3,277	4,384	4,366	3,855	3,345
Oil receipts	844	1,080	1,316	1,396	1,326	1,839	2,407	3,260 [d]	3,060 [d]	2,601 [d]	2,167 [d]
General reserve fund [e]							502	583	540	459	383
Other (includes grants and development loans)	58	250	147	378	147	345	368	541	766	795	795
Expenditures	954	1,435	1,682	1,547	1,621	1,883	2,677	3,400	4,039	4,350	4,350
Defense and national security	341	698	785	686	767	779	1,178	1,511	1,714	1,750	1,750
Civil purpose (mainly social welfare and development spending)	553	660	820	773	704	851	1,172	1,532	1,879	2,100	2,100
Government share of PDO [f]	60	77	77	88	150	253	327	357	446	500	500
Domestic net lending and equity participation	117	−3	1	23	53	18	73	111	269	300	300
Balance	−169	−102	−220	204	−201	283	527	873	58	−795	−1,305

[a] Estimated.
[b] Projected. Revenues based on an oil price of $28 to $30 per barrel.
[c] Projected. Revenues based on an oil price of $25 per barrel.
[d] Excludes transfers and allocations to the General Reserve Fund.
[e] Approximately 15 percent of oil income is diverted into the State General Reserve Fund, established in 1980.
[f] Petroleum Development Oman (PDO).

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percent annually in recent years to promote domestic stability—especially in politically vulnerable areas such as Dhofar, Muasandam, and the interior.

Oman's economic growth in 1983—barring a further sharp drop in oil prices—is likely to slow to about 5 percent compared to over 30 percent in recent years. Senior Omani officials are aware that a return to the rapid growth of the late 1970s is unlikely. We believe that slower growth need not be politically threatening, however, if the government maintains its social programs.

Deficit Scenarios and Funding Options

If oil prices stabilize between $28 and $30, we estimate that Oman would have a small surplus on its current account or run only a small deficit. The budget would run a deficit of almost $800 million on expenditures of almost $4.4 billion—a significant turnaround from last year's budget surplus of about $60 million. Oman last had current account and budget deficits in 1978.

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Gulf Assistance. Oman probably would seek additional assistance from Arab sources—particularly the Gulf Cooperation Council—to soften the im-

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pact of lower revenues. The GCC has already agreed in principle to grant Oman $1.8 billion over the next 12 years to purchase military equipment. Oman, however, probably will not receive the entire amount because the Gulf states will be constrained by their own cash-flow problems.

In addition to possible GCC military aid, we estimate that Oman can look for at most $100 million in development aid from Arab donors in 1983. The Saudi Fund for Development has already approved loans totaling $16 million to finance two projects—a technical institute and a vocational training center—both located in the interior. At least two other projects for the Dhofar region may receive Saudi aid.

Turning to the United States. We believe Oman will seek additional financial assistance from the United States, citing Oman's reduced revenues, its role as a reliable military partner, and its increased importance to security in the Persian Gulf region, including the strategic Strait of Hormuz. According to the US Embassy in Muscat, the United States has provided $40 million in Foreign Military Sales credits for the 1983 fiscal year, $10 million in Economic Support Fund loans, $5 million in ESF grants, and $100 million in International Military Education Training grants.

Other Options. Oman—with a debt service ratio of less than 6 percent—could easily borrow on the international market. Oman is reportedly considering a $300-400 million Euromarket loan, in part to establish its credit rating for future contingencies. A decision on whether to go ahead is expected within the next five months. Oman last went to the Euromarket in 1979 when it received a $200 million medium-term loan.

Oman could also draw on its official foreign assets. We estimate Oman's official assets to be about $4 billion (including net commercial bank assets), about one year of imports of goods and services. Oman has drawn on its reserves several times in the past, most recently in May 1982. Faced with liquidity and cash-flow problems because of oil revenue shortfalls, the government then withdrew deposits from the Sultanate's commercial banks. 25X1

If oil prices drop to $25, we estimate that Oman would run a current account deficit of about $400 million and a budget deficit of $1.3 billion. Funding such large deficits would quickly deplete Oman's assets. Although Oman probably would increase its requests for foreign aid under this scenario, we believe the government is not likely to receive much over the $400 million it is already getting from Arab donors and the United States. 25X1

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Foreign exchange difficulties caused by a sharp drop in oil prices could be used by the government to justify tough spending reforms, but this would not be well received by most Omanis. So far, Qaboos has not prepared the public for harsh austerity measures. Revenue shortfalls would most likely touch off intense competition for resources and stimulate criticism of high defense expenditures and the role of foreigners in the Omani military, political, and economic system. 25X1

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Spending Cuts. With $25 oil, Oman would probably be forced to make deep cuts in spending. Omani leaders, however, would be loath to cut social welfare and economic development programs, each making up about 25 percent of the budget. They are concerned about Omani discontent over unequal distribution of wealth between the relatively rich capital and coastal areas, and the less developed interior and the Dhofar. Cuts in development projects would be likely to increase popular criticism of official corruption and perhaps Qaboos' extravagent palaces and lifestyle. Cuts in imports of consumer goods could be politically destabilizing among Omanis accustomed to fast-paced growth and improving living standards. 25X1

Military cutbacks are unattractive to Qaboos but are a more likely target for economies in an era of reduced revenues. Oman's allocation of 40 percent of its budget to military and security spending is one of the highest in the world in both percentage and per capita terms. Oman would be reluctant to

Oman: Current Account *Million US $*

	1974	1975	1976	1977	1978	1979	1980	1981	1982 [a]	1983 [b]	1983 [c]
Trade balance	600	407	484	481	329	852	1,683	1,975	1,750	1,130	530
Exports and re-exports, f.o.b.	1,213	1,416	1,595	1,619	1,598	2,280	3,748	4,696	4,480	4,025	3,425
Imports, c.i.f.	613	1,009	1,111	1,138	1,269	1,428	2,065	2,721	2,730	2,895	2,895
Services and private transfers	−444	−558	−494	−447	−418	−522	−633	−793	−950	−1,140	−1,140
Grant receipts	24	207	52	268	20	179	102	145	72	200	200
Current account	**180**	**56**	**42**	**302**	**−69**	**509**	**1,152**	**1,327**	**872**	**190**	**−410**

[a] Estimated.
[b] Projected. Data based on an oil price of $28 to $30 per barrel.
[c] Projected. Data based on an oil price of $25 per barrel.

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cut the size of its armed forces or reduce their funding because of perceived threats from South Yemen and Iran and the risk of provoking dissidence in the military. Nonetheless, delay or even elimination of some weapons purchases probably would be made, particularly if revenues declined significantly. Failure to cut military spending would expose the government to popular criticism for slighting civilian needs. [redacted] 25X1

We believe the government probably would be able to minimize popular dissatisfaction in the near term. If the economic downturn continues beyond 1983, however, the government would be forced to adopt even tougher measures, creating a potential for political unrest. [redacted] 25X1

[redacted] 25X1

Morocco: Mounting Financial Problems [redacted]

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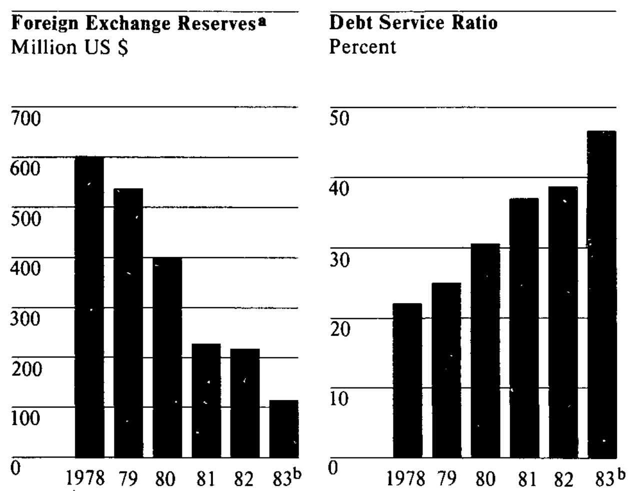
Hit in recent years by the depressed phosphate market and a severe drought, Morocco resorted to foreign borrowing to cover growing current account deficits. As a result, foreign debt has doubled and the debt service ratio is approaching 50 percent. With meager foreign exchange reserves and the country's creditworthiness in doubt, King Hassan may be forced to come to terms with the IMF and is likely to press the United States for additional assistance. Dealing with the country's serious financial situation may preclude significant economic growth or improvement in the standard of living, and Hassan may have to rely more heavily on his security forces to maintain order. [redacted]

Morocco: Foreign Financial Indicators



[a] End of period, excluding 704,000 ounces of gold.
[b] Projected.

[redacted]

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Economic Problems Mount

The collapse of the phosphate market—Morocco's major export commodity—in 1976 constrained export earnings. High defense costs related to the Saharan conflict and a severe drought in 1980-81 boosted the import bill. Import volume remains at about the 1978 level despite the massive food imports of recent years; maintaining even this level of imports, however, was made possible only by generous assistance from Saudi Arabia and heavy foreign borrowing. Foreign debt reached $10 billion at the end of 1982, equivalent to two-thirds of GDP and double the 1978 level. As a result of this rapidly growing debt, Morocco's debt servicing costs reached 39 percent of receipts from goods and services last year and is expected to reach 46 percent this year. Foreign exchange reserves have been depleted to the point where they now cover less than one week of merchandise imports. [redacted]

The austerity measures imposed in 1978 and a severe drought in 1980-81 combined to slow economic growth and to produce widespread unemployment, and added to urban economic malaise. Real GDP growth has averaged only 2.8 percent since 1978 in sharp contrast with the heady 7.0-percent growth of the previous five-year period. Unemployment in major cities approaches 25 percent, according to Embassy reporting. Double-digit inflation has wiped out wage increases in recent years. [redacted]

The nation's five-year development plan (1981-85) has suffered a serious blow because of the foreign exchange shortage and is in danger of being scrapped. Investment under this plan is already far 25X1

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behind schedule. The modern sector, such as construction and manufacturing, has been especially hard hit. [redacted]

1982: A Weak Recovery

Agricultural production rebounded sharply in 1982 as the most severe drought to hit Morocco in 40 years was finally broken. A near-normal cereal harvest of 4 million tons was achieved—double the production in 1981. Improvement in this sector—three-fifths of the population is involved in agriculture-related activities—was the primary cause of the 4-percent gain in real GDP. Other sectors showed little gain, however, with output in the mining sector declining sharply due to the soft world phosphate market. [redacted]

Declining phosphate revenues and the continued need to import large amounts of grain to replenish stocks increased the current account deficit to $2 billion. Rabat was forced to trim its phosphate rock prices by 19 percent to $40 per ton during the year; as a result, foreign exchange earnings from phosphate exports dropped by $200 million. Petroleum imports consumed 56 percent of export earnings. [redacted]

Morocco relied heavily on foreign borrowing again in 1982 to finance its current account deficit, in part because support from Riyadh dropped by half to $350 million. Rabat was forced to negotiate a one-year, $560 million standby and cereals option loan with the IMF in April 1982. In addition, $94 million in economic and military assistance was provided by the United States in 1982. [redacted]

1983: Tenuous Prospects

While agriculture is picking up, Rabat is still struggling with the impact of depressed phosphate earnings and the payments required to service past borrowing. If Morocco is able to reach a new standby agreement with the IMF and line up bilateral support, the nation's economy should be able to repeat last year's performance. There are considerable downside risks, however, because of the country's weak financial position. [redacted]

Baseline Scenario. Despite austerity measures and the depressed phosphate market, agriculture's continued improvement will probably allow Morocco to repeat last year's 4-percent economic growth. As the country continues to recover from the effects of drought, the grain harvest should reach 4.5 million tons—12 percent above last year—and exports of citrus should grow by 11 percent. The construction and chemical industries will show some improvement, but growth in other sectors will remain slow. [redacted]

The government budget will provide little stimulus this year, since planned expenditures remain about the same in real terms. New import controls and restrictions in foreign currency transactions, however, will limit revenue growth, causing the budget deficit to increase by about $170 million. Lower import prices and reduced consumer demand should help slow inflation to about 13 percent. [redacted]

Morocco's phosphate industry, which accounts for 8 percent of GDP, remains depressed. Phosphate rock sales—29 percent of export earnings in 1982—are unlikely to increase from the reduced level of 16.5 million tons shipped last year. Rabat may be forced to cut rock prices further to preserve its market share [redacted] Such a cut would reduce export earnings, offsetting savings from the $5-per-barrel drop in oil prices. Earnings from processed phosphates—16 percent of exports last year—have remained firm. [redacted]

Despite import controls, we believe that the current account deficit will most likely show only a modest improvement to $1.9 billion in 1983. Although import volume will decline slightly with consumer and capital goods being hardest hit by import controls, exports will remain stagnant. About $2.7 billion will be necessary to cover the current account deficit and debt repayment—bilateral loans will probably be the primary source of funds since

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Morocco: Balance of Payments

Million US $

	1978	1979	1980	1981	1982	1983 [a]	
						Best Case	Worst Case
Current account balance [b]	−1,348	−1,565	−1,469	−1,893	−2,057	−1,884	−1,584
Merchandise trade balance	−1,126	−1,336	−1,381	−1,557	−1,772	−1,580	−1,280
Exports, f.o.b.	1,502	1,997	2,425	2,283	1,960	1,970	1,970
Phosphates and derivatives	585	744	1,009	1,080	874	756	756
Imports, f.o.b.	2,628	3,333	3,806	3,840	3,732	3,550	3,250
Fuel and lubricants	379	638	1,012	1,200	1,099	993	993
Services (net)	−235	−215	−96	−361	−313	−330	−330
Receipts from tourism	290	333	356	338	340	350	350
Worker remittances	735	957	979	963	992	1,020	1,020
Private transfers (net)	13	−14	8	25	28	26	26
Capital account balance	1,461	1,500	1,330	1,723	2,046	1,782	1,482
Private loans (net)	−28	115	−115	47	50	45	45
Official grants	NEGL	430	97	314	230	250	250
Public-sector loans (net)	1,369	965	1,181	1,238	1,212	1,138	1,038
IMF drawing (net)	70	−29	127	164	442	300	100
Other flows, errors, and omissions	50	19	40	−40	112	49	49
Change in reserves	113	−65	−139	−170	−11	−102	−102

[a] Projected.
[b] Balance before official grants.

[redacted] 25X1

commercial lenders are leery of increasing their exposure. French support has been increased to $272 million this year from $195 million in 1981. Reduced oil revenues, however, will probably preclude an increase in Saudi assistance. [redacted]

Worst Case Scenario. There is, however, a strong and growing chance that Morocco will not be able to secure all of the required financing. Agreement on a new IMF loan for 1983 may prove difficult. Failure to address food subsidies—a politically sensitive issue—the growing budget deficit, and insufficient progress on reducing the current account deficit have impeded progress to date. Talks aimed at assessing a new program may resume in May. We believe Morocco will need about $300 million in IMF funding this year. Debt service costs will rise 24 percent this year to $1.7 billion and will continue to rise through 1986 even if the outstanding foreign debt remains constant. [redacted] 25X1

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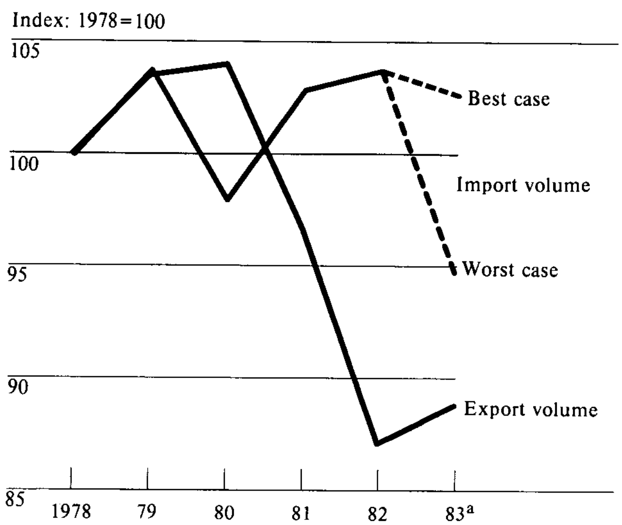
If Rabat is unable to secure sufficient financing, large cuts in imports and government spending will be necessary. Assuming a $300 million shortfall, import volume would have to be cut by an additional 8 percent to make up the difference. The additional cut in imports, especially capital goods, could cause economic growth to plunge and social discontent could easily increase. Failure to reach an agreement with the Fund could also result in

Morocco: Foreign Trade Indicators



[a] Projected. Worst case for import volume assumes $300 million shortfall in financing in 1983.

[redacted]

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bankers' being even more unwilling to provide new loans to Rabat. Under these circumstances rescheduling of part or all of Morocco's outstanding debt obligations would likely become necessary. [redacted]

The government is already considering new austerity measures to deal with its growing financial problems, according to Embassy reporting. The budget may be reduced with investment again taking the sharpest cut, as it did in 1982. Harsher import controls and more stringent restrictions on foreign currency transactions may be implemented to stem the outflow of scarce foreign exchange. Such measures, if enacted would cause a rapid economic slowdown and raise the prospect of popular disgruntlement. [redacted]

Domestic Political Implications

King Hassan's position appears secure for the near term if our baseline scenario holds. The potential for rapid financial and economic deterioration, however, make his longer term position increasingly less secure. Under the worst case scenario, the government's ability to meet the growing demands of the large and youthful population would be sharply curtailed. The potential for a rise in public and political unrest would be greatly increased, forcing Hassan to rely heavily on his security forces to maintain order. [redacted] 25X1

Criticism of the regime's economic policies has grown among labor unions, students, and the unemployed. Despite the King's crackdown following the June 1981 riots in Casablanca, these groups still have the potential to cause problems. The King's reluctance to entertain criticism and advice—especially on the economy—and his preoccupation with foreign policy concerns have contributed to his growing isolation and increase the risk that effective measures will not be implemented. Hassan will, in any case, probably delay taking significant action on the economy until after parliamentary elections scheduled for later this year. [redacted] 25X1

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Hassan continues to have the support of Morocco's military and security services. Military morale, however, could be adversely affected by a sharp reduction in defense spending or a cut in Saudi support for the Saharan conflict. A further decline in the standard of living within the officer corps could also reduce morale and cause disgruntlement. In addition, a Saharan settlement perceived to concede too much in diplomatic terms could cause discontent within the military and would have to be balanced against any financial resources that a settlement might release. [redacted] 25X1

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Concerns for the United States

Morocco's burdensome trade position has resulted in some Moroccan officials pressing for expanded trade with Eastern Europe and the Soviet Union. While such trade is currently limited—7 percent of imports and 11 percent of exports in 1982—prospects are good for increased barter trade in phosphates, citrus, and agricultural goods. Eastern Europe is also viewed as a source of technical assistance with attractive credit terms for major development projects. To date Hassan has opposed stronger trade ties with Communist countries but may be forced by economic conditions to capitulate. [redacted] 25X1

Rabat's weakened financial position and the lower level of Saudi aid expected this year impairs the nation's ability to meet arms contract payment obligations. Morocco is already about $46 million in arrears to the United States for FMS payments: Rabat failed to pay a requested $10 million installment by 31 March under a compromise arrangement and now faces a suspension of its $23 million FMS allocation for FY 1983 under the Brooke Amendment. An additional $18 million in outstanding FMS loans must be repayed by the end of the fiscal year. Military payment obligations to the French have also begun to mount despite a rollover of such debts in 1982. [redacted] 25X1

The government may petition the United States to influence the IMF on Rabat's behalf to secure additional balance-of-payments support. Rescheduling of Morocco's FMS arrearages may also be raised. Rabat is interested in acquiring additional US support for the development of its agricultural and fisheries resources. In addition, support for Rabat's attempt to attract US investment may be requested. Should economic growth decline sharply, closer US-Moroccan ties, while initially well received, could become the focus of opposition rhetoric from dissatisfied elements—including the military—who would blame the King for failing to obtain sufficient US economic concessions to keep Morocco afloat. [redacted] 25X1

[redacted] 25X1

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